The Challenges of Financing a Share Issue: An Empirical Investigation for Tunisian and French Companies

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Abstract

The aim of this paper is to study the impact of funding by issuing shares on the performance of the company. First, this work focuses on the conceptual framework of the interests of the financing package of debt and issuance of the shares. Second, it checks the implications of this issue on the performance of French and Tunisian companies.

Keywords: Debt - Issuance of shares - Performance – Finance, Tunisian and French firms. JEL Classification: G32, L25

1. Introduction

The explanation of the differences in the firm performance continues to occupy a prominent place in literature, particularly since the publication of the article by Schmalensee (1985). In their interpretative efforts, economists and managers have given a clear primacy to the terms of corporate finance. Also, the financial structure does become established as the main factor affecting the company performance, basically approximated by the value of the firm. However, the term value is not unanimous. It is transformed over the years. Typically, the company was analyzed as an entity characterized by contractual relationships. Its value has been defined by the profit, stakeholder value and ultimately, shareholder value (Gaby and Hirigoyen, 2001).

However, most studies have thus limited to studying the relationship between performance and debt, as they are less interested, to our knowledge, the effects of the financing package of debt and issuance of the shares of performance of the company. Some studies suggest that equity financing has a positive effect on the firm performance (Dietsh and Brigitte, 1998). In this research, we use panel data estimation. This technique allows dealing jointly with the individual effects and time to show the impact of the introduction of funding through a capital increase performance of the company.

2. Theoretical development

Analysis of the results found in previous work on the determinants of performance show that debt can have two possible effects on performance: First, the use of debt could discipline the behavior of leaders. These goals concentrate on productivity, operational efficiency and, consequently, the profitability of the company. On the other hand, debt financing could be profitable for the company. It could limit the amount of resources
available to deal with competition and financing of major projects profitable and innovative. The debt limits
the power of leaders and led to increases intake may influence the profitability of the company and its
position.
The relationship between debt financing and the performance is so ambiguous. The study of this interaction
within the listed and unlisted companies has led us to believe that the debt would increase the level of
performance but at a decreasing rate. The impact of such funding, however, depends largely on the various
constraints imposed on the company, influencing later, the financing decision. There are two types of
constraints:
The first category relating to the regulation is related to the life cycle of the company and has led some
financial innovations. Explained by the emergence of new financial products, this constraint supports the
concentration of capital.
The second category is resulted from the business environment and makes a great extent due to the
internationalization of financial activity. In this sense, Van Home (1925) points out that the viability and
competitive forces are the result of financial innovation. Financial institutions are encouraged to innovate.
Institutional liberalization of financial activities, the openness policies, financial globalization and growth of
capital markets have led a growing internationalization of financial activities and introduced a new form of
competition.

2.1 Constraints of corporate life
The main constraints relate to:
The behavior of managers and shareholders: The theory is managerial, heavy use of the company to direct
finance is likely to make the ownership of shares in the company more dispersed and allow leaders to
exercise power specific strategies of the company. This domination of leaders can lead to ambiguous effects.
It can be clearly positive implications on the objective of maximizing profit, but also cause conflicts between
the same manager and shareholders of the company, thus generating agency costs. The extent and type of
these conflicts are in large part related to the degree of separation of ownership and control and are limited by
the objectives of incentives that leaders opposed to shareholders (Hergli, 1999).
The conflict of interest: The business owner who uses the loan for the financing needs commitment, a priori,
to reimburse his company, regardless of the performance achieved, interest and principal. The costs of
borrowing are fixed in advance and are completely inseparable risks borne by the owner, which is not the
case when the said contractor finances its business by issuing shares.
The default risk: if the debt does not reduce the control of the company on its operations as its choice, the
default risk increases, which would be fatal to drive the company towards a situation of bankruptcy.
The costs of bankruptcy have a greater importance when the company is small. They are not negligible and
can be divided into two categories (Malecot, 1984): i) Direct costs: have administrative costs, financial costs,
reorganization costs, agency costs, the costs of forced sale of assets and urgent and social costs. ii) Indirect
costs: costs have picture (financial credibility and commercial) and opportunity costs (foregone).

2.2 Constraints related to the business environment
The inefficiency of the banking system: Banking systems suffer from two main problems: i) An inadequate supply of products and banking services: The proper management of the various
components of the balance sheet relates to the experiences of the banker should seek and receive adequate
resources and stable. Moreover, it must grant credits taking into account the couple risk-client-related
liquidity constraints and interest rates.
However, Tunisian banks have failed to implement a strategy well suited to mobilize savings to collect resources. The products are indeed unattractive because of these characteristics. They are often limited to deposit accounts or deposit accounts. These products have generated interest among the general public. However, the main problem is largely related to the security of investments. Indeed, if the customer safety is not ensured by the banker, it can provide to collect massive stable and sustainable. In this case, trust must be implemented.

ii) An inefficient banking: The supply of credit should be based on a thorough risk. The credit can be offered and awarded on the basis of economic criteria and specific guarantees. Today, after the financial crisis, the laxity and complacency of banks in granting loans are notorious. The slippage in the supply of credit results in failure of the debtors, and the stability of the entire financial system is called into question.

The nature of competition: Often, the financial structure of the company is strongly influenced by the strategies developed to cope with the competition. The company tends to substitute more and more equity to debt when the approach of the competition is made by the kiss of a technological, a revitalization of the research and development of continuous improvement of quality and a consistent respect for market standards. This substitution has been explained in large part, by research funds inexpensive and stable, more or less long term. In contrast, when the strategies of the conquest of the market and the fight against competition is based on an approach to marketing or commercial debt is a big place, which is notably the case of companies that have operations strong financing needs.

The financial repression: Under the influence of an environment characterized by both financial repression and credit rationing. The low interest rate and credit controls are likely to produce an excess of demand funds from the banking system. This excess is confirmed by the practice of capital structure more risky (risk of default) to improve the financial return (financial leverage).

In a context of debt financing, firms operating in the priority activities are favored over others. Within these activities, companies are expected to generate little equity. These are private companies that adjust their funding structure in the direction of strengthening the share of debt capital. This also means that a capital structure more risky not only adopted by companies generally benefit guarantees by public authorities. Rather, the companies left to their own and are based on their performance that adopt such a capital structure.

The nature of the industry: In terms of the nature of the industry, the analysis is focused on the anchor points that can be associated with the nature of the market demand and Finally, the character of the integration of the industry.

The capital structure of the company is sensitive to the wide variety of manufactured products, which require on the part of the company, significant working capital and most important sources of cash easily mobilized. The company will therefore tend to pay more attention to its relations with banks and will base its funding on debt.

The nature of the market is also a component characterizing the industry. The capital structure of the business is suited to the characteristics of the market to which it belongs, that it is more or less dynamic, competitive and subject to certain restrictive practices.

The findings are different with respect to the integration of the industry belongs to the company. A more integrated industrial relations of exchange with the other sustainable industries, and be less dependent on the outside in case of downturn in foreign markets. In this way, the integrated and influenced by this type of industry should choose debt financing if its purpose is primarily and regularly, on strengthening its market share, which requires a financial base fixed medium and long term. Financial growth of the company is instead achieved on the basis of the improvement and protection of its own funds by the use of debt.
In total, these constraints and difficulties are the cause of the financial imbalances that usually knows the business. These problems lead firms to rely heavily on debt capital to ensure the survival of the company. Such a problem results in economic and financial difficulties that can sometimes lead to bankruptcy of the company. In most cases, the difficulties do not appear suddenly. Before the company is bankrupt, it goes through situations of financial distress: insolvency, failure to settle the debt, lack of liquidity... The Financial distress does not mean the failure or bankruptcy. This is a step in the process of failure encouraged by economic problems. It means in effect, a temporary insolvency or lack of liquidity can be solved by a restructuring of assets and / or liability. This situation can lead to bankruptcy in the absence of appropriate action. Therefore, resolution of defects resulting from this mechanism forms what is called the costs of financial distress. In France, much research has been conducted to identify the causes of failure of French companies. These studies were concluded with the proposal of the main causes, which are largely related to mismanagement. Among these errors, we cite the lack of a control system of management, cash flow problems associated with the failure of the customer, the realization of risky projects, etc.. However, in the case of Tunisian companies, mismanagement is a major cause of distress, even business failure. This difficulty has led 75% of cases and due to a bad choice in the financing of selected projects. In general, the Tunisian companies are financed, primarily by means of debt. Financial autonomy is limited by the high financial costs incurred due to these investments. These same statistics show that other causes of financial distress due to competition, weak marketing effort, the problems of export, etc.. Rising costs of financial distress and the costs of membership constraints stimulate the search for a funding strategy most appropriate to the performance of the company. Recently, financial theory has dealt with this problem of choice in terms of incentive problems and monitoring of debt and the issuance of shares.

2.3 The role of information and incentive of debt
The impact of debt financing on performance is related, in large part to the effectiveness of conditions of debt contracts, which is to say to the warranty conditions. A strong long-term debt forced the company not to engage in projects to amend the respect of its financial commitments. In addition, funding favoring short-term debt obliges the company to achieve its investment under the same threats. It would be forced to retain unprofitable projects so as not to allow borrowing to rise. The conditions of contracts of debt are also a source of information for both parties. In deciding to increase the level of debt and supporting a risk of bankruptcy, the leader increases the level of profitability will be achieved in the future. It sends "a signal" about the new situation of the company.

2.4 The role of information and control the issuance of shares
The shares also play a role of information and control: a higher proportion of shares held by managers tend, first, to increase and improve performance. This reduces the holding high moral hazard problems and increases the incentive of personal leadership. Second, the financial market plays a monitoring role for the company in achieving the object of regular investigations of analysts. Furthermore, when the leaders follow financial policies and in accordance with the dividend expectations of shareholders, they respond to calls of the market which is essential for growth and sustainability of the company. Finally, the funding issue of shares is a better risk sharing than debt financing. The positive effect of equity financing on performance depends largely on the benefits it gives as a referent of a long-term relationship. Equity financing supervises and provides leadership to the company, an inflow of funds. Financing by issuing shares regularly forced to distribute dividends and to meet the requirements of transparency. Otherwise, the company could, under certain conditions, a tender offer.
To this end, we propose to split the funding into two categories: debt financing and that by issuing shares. After this development, we can put the following hypothesis:

**Hypothesis:** The interaction between performance and dosing debt-issuance of the shares is positively significant.

3. The empirical study
In what follow, we will present respectively the sample, the definition and measurement of the variable and the finding of our regression.

3.1 Data and methodology
Our sample consists of 80 listed companies (Tunisian and French companies). The companies belong to four major sectors: industrial, services, consumer goods and, finally, technology sector. The quantitative data are derived from annual reports published on the website of the companies concerned. They are supplemented by data available in the reports of the Financial and fiscal Market Council and the Bank of France for the period from 1998 to 2006. We developed two models, as the dependent variable is operating income to total equity, or that this variable is value added divided by sales. So our model can be written as follows:

\[
\text{PERF}_t = \alpha_0 + \alpha_1 \text{DEBT}_t + \alpha_2 \Delta \text{KS}_t + \alpha_3 \text{PPM}_t + \alpha_4 \text{IMMOB}_t + \epsilon_t
\]

The dependent variable is the firm performance. As was defined in the first section, the two performance measures are:

- **RERF**$_{i,t}$: it is the ratio of operating income based on the sum of equity of firm i at time t. The equity includes equity capital, reserves, retained earnings and capital grants.
- **VACA**$_{i,t}$: is the ratio of value added to total revenue of firm i at time t.

For The explanatory variables we can note:

- **PPM**$_{i,t}$: This is the percentage of equity held by controlling shareholders.
- **DEBT**$_t$: This is the level of debt in the short and long-term to total assets of firm i at time t.
- **Δ KS**$_{i,t}$: This is the variation of the share capital of firm i at time t. This variable indicates the amount of the shares. It is divided by total assets.
- **IMMOB**$_{i,t}$: It is the ratio of gross fixed assets to total assets. This variable gives us an idea about the structure of assets of firm i at time t.

Recall that our goal is to explore the relationship between performance and debt financing and issuance of the shares. The methodology used in the context of this empirical analysis is the panel. It is a form of multiple regressions that treats the parallel temporal effects and individual effects (Kremp et al (1999)). This technique takes into account individual heterogeneity, which is not possible with other estimation techniques. In addition, we performed the Hausman test to specify the model or by the inclusion of a random effect or fixed effect.

The variable Δ KS allows to outline the relationship between performance and finance by issuing shares. The expected sign of coefficient α2, linked to the variable (Δ KS it), is positive. Indeed, a positive sign of α2 highlights this relationship and emphasized the existence of a dependency between these two variables. We expected a positive sign of α1 related to variable debt financing. Thus accentuating the results found in the first section, in which unlisted companies use as a priority to short-term debt, and that listed companies use more debt in the long and medium term.
3.2 Results and interpretation

Table 1: Results of random effects regression of performance ratios

<table>
<thead>
<tr>
<th>The Dependent Variable</th>
<th>French companies</th>
<th>Tunisian companies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>M1 (Performance = VACA), (EA)</td>
<td>M2 (Performance = REFP), (EA)</td>
</tr>
<tr>
<td>∆KS</td>
<td>0.244** (0.02)</td>
<td>0.0048*** (0.000)</td>
</tr>
<tr>
<td>DCTAC</td>
<td>0.012 (0.9)</td>
<td>0.07** (0.025)</td>
</tr>
<tr>
<td>DLMTAC</td>
<td>0.0006* (0.000)</td>
<td>0.82*** (0.000)</td>
</tr>
<tr>
<td>PPM</td>
<td>0.13** (0.05)</td>
<td>-0.314*** (0.006)</td>
</tr>
<tr>
<td>IMMOB</td>
<td>0.00018* (0.07)</td>
<td>0.004*** (0.000)</td>
</tr>
<tr>
<td>P chow</td>
<td>(0.005)*** (7.468e-11)***</td>
<td>0.0007*** (0.000)</td>
</tr>
<tr>
<td>Hausmann</td>
<td>5.71 (0.33)</td>
<td>0.35 (0.99)</td>
</tr>
<tr>
<td>Breusch-Pagan (LM)</td>
<td>520*** (0.000)</td>
<td>44.44*** (0.000)</td>
</tr>
<tr>
<td>Nombre d'observations</td>
<td>359</td>
<td>358</td>
</tr>
</tbody>
</table>

Chow test is significant for both models for both business and valid and individual behavior. In the Tunisian companies, the Hausman test is not significant for both models. The significance is noted at the test Breush Pagan (LM). This leads to hold the random effects specification for both models.

Also, in French companies estimate a random effect is retained for both models. The coefficients for the variable ∆ KS have the expected signs and are also statistically significant. This positive coefficient shows a relationship between equity financing and business performance.

By examining the significance of other variables, we note that the variable long-term debt and medium term, plays a positive role and that its coefficient is significant in both models. In fact, the best performing listed companies use debt financing in the long and medium term. Similarly, the variable associated with the share of managerial ownership is negatively significant at 5% for the first model, while it is not for the second model in the case of French companies. While she has negative signs in both models for Tunisian companies.
The performance decreases with the equity participation of controlling shareholders. Our results demonstrate that a mixed financing, debt and issuance of the shares, which is the best way to encourage better performance. This is largely due to the fact that investments in debt and equity are substituted by characteristics of market. Indeed, in all circumstances and in case of bankruptcy, shareholders may initiate partial or complete liquidation, or change management. This result corroborates our hypothesis that shows the relationship between performance and debt financing and issuance of the shares is positive. High debt tends to increase the performance because it leads managers to better management to prevent the increased risk of failure. In addition, the extent and importance of their commitment to the borrowing firm, lenders are urged to exercise greater control due to the increase in debt. Similarly, a higher weight increase of capital tends to increase performance. This increase not only enhances the direct encouragement of the leaders shareholders, but it also helps improve and increase information available to outside shareholders and thus limits the phenomena of adverse selection and subsequently reduces the problems of divergence of interest. Ultimately, a financial structure consists of equity and debt can enhance performance because it reduces the discretion of management. We corroborate the theory of financial structure and hierarchy can conclude that a higher level of share issue contributes unambiguously to address business performance regardless of their size. Therefore, the costs of monitoring and management tend to decrease as long as the overall equity capital of the company.

In total, the increase in the share issue like all the other sustainable resources contributes, on average, reduce costs and increase profitability regardless of the degree of ownership concentration. Contrary, the debt positively and significantly influences the performance in the case of firms characterized by concentrated ownership. Therefore, the companies are subject a problems of management entrenchment.

Conclusion
To explaining the factors affecting the performance, we also note that the various financial constraints the company is at the root of a performance sensitive to the debt and ownership structure. These constraints give rise to the hypothesis of selection of a balanced financial structure between debt and issuance of the shares. This hypothesis is tested and confirmed in a financial market with, on a sample of 80 companies listed on the period from 1998 to 2006. The results show that the variable of debt financing and changes in capital positively affects the performance and the profitability of the firm. While the concentration of capital is correlated negatively with the firm performance, which requires the need for adequate funding strategy. This match means the stability of the structure and especially its component shareholder.

References